



High Court of New Zealand

12 December 2011

MEDIA RELEASE – FOR IMMEDIATE PUBLICATION

**Alesco New Zealand Ltd and ors v Commissioner of Inland Revenue
CIV 2009-404-2145 DATED 12 December 2011**

PRESS SUMMARY

This summary is provided to assist in the understanding of the Court’s judgment. It does not comprise part of the reasons for that judgment. The full judgment with reasons is the only authoritative document. The full text of the judgment and reasons can be found at www.courtsofnz.govt.nz

Alesco New Zealand Ltd and other subsidiary companies challenge decisions of the Commissioner of Inland Revenue to declare an arrangement void as a tax avoidance arrangement. They also dispute the Commissioner’s decisions to disallow interest deductions and loss offset elections in recalculating the taxpayers’ taxable income, and his decision to impose shortfall penalties.

Alesco NZ is a wholly owned subsidiary of Alesco Corporation Ltd, an Australian company. The arrangements at issue were the use of optional convertible notes in an intra-group situation to finance the acquisition of two businesses operated by New Zealand based companies.

Alesco NZ issued optional convertible notes to Alesco Corporation Ltd in return for advances totalling \$78 million, for a term of 10 years, at the end of which Alesco Corporation had the option of being repaid \$78 million or converting the notes into 78 million new Alesco NZ shares. The taxpayers claimed amortised interest deductions in accordance with financial arrangement rules, which stipulated that such “hybrid” instruments be treated as containing both debt and equity elements. The interest notionally received by Alesco Corporation was not taxable as such notes were treated as equity instruments under Australian tax legislation.

The High Court found that tax avoidance was established. Justice Heath found that although the accounting treatment of the notes was appropriate, the tax advantage secured was not within parliamentary contemplation. There were three main reasons for this. First, there was no corresponding taxable income return for the expenditure incurred. Secondly, the option component of the arrangement was artificial because it had no value to Alesco Corporation as Alesco NZ's parent and because there was no negotiation between the parties to the subscription agreement, unlike in an arm's length transaction. Thirdly, no real interest expense had been incurred and the notional interest claimed did not represent a real economic cost. Nor did the notes have any inherent economic value to an arm's length third party.

Justice Heath also found that the Commissioner was entitled to disallow all the interest deductions and loss offset elections arising from the use of the optional convertible notes to counteract the tax advantage gained. The Commissioner was not required to act on evidence that Alesco NZ would have funded the acquisitions through an interest bearing loan from Alesco Corporation had the notes not been used.

Finally, Justice Heath upheld the Commissioner's imposition of a shortfall penalty of 50 per cent of the tax deductions claimed. This was on account of the "abusive tax position" Alesco NZ had taken, reduced for its prior history of compliance. The High Court held that Alesco NZ had taken an "unacceptable tax position" and that viewed objectively, the arrangement it had entered into had a dominant purpose of avoiding tax, such that the tax position Alesco NZ had taken fell within the definition of an "abusive tax position".

As a result, each of the challenges to the Commissioner's assessments was dismissed.